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Financial Markets

Irving Trust

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Signs of recession are beginning to spread from the equity and commodity markets to interest rates. Many stock and commodity prices are now off sharply from their peaks, but interest rates have been resisting this trend. This week, however, Treasury Bill rates began to fall in response to further weakness in stocks and commodities. It is not surprising that a decline in equities and commodities has preceded a decline in interest rates. Both stock prices and commodity prices are components of the composite index of leading indicators compiled by the Commerce Department. The prime rate, on the other hand, is a component of the index of lagging indicators. Thus a peak in stock and commodity prices typically precedes a peak in interest rates, as it has this time.

The Federal Reserve's new credit restraints should add to the downward pressure on rates. Not only will these restraints tend to hasten a downturn in the economy, but they will also reduce the demand for funds. Banks that must restrict their loans because of the new program will sell fewer C.D.'s. This will reduce the demand for funds and tend to lower interest rates. It is true that some of the reduction in sale of C.D.'s will be offset by increased direct sale of commercial paper by corporations that are denied bank loans. But smaller firms and poorer credits do not have access to the commercial paper market and will not be able to circumvent the restrictions in this way. One implication of this analysis is that the Fed's new program discriminates against small firms and weaker credits and in favor of large firms that have access to the commercial paper market. Another implication is a narrowing in the spread between the rates on commercial paper and bank C.D.'s as banks sell fewer C.D.'s and corporations sell more commercial paper, pushing up the rate on paper toward that on certificates.

Another spread relationship likely to change as a result of the new program is that between the rate on Fed funds and C.D.'s. More banks are now subject to the marginal reserve requirement because of the reduction in the base to which the marginal requirement is applied. Since Fed funds purchased from members are exempt from the marginal requirement, these funds are now going to look more attractive to more banks. This should push their rate up relative to that on C.D.'s for which the marginal requirement applies. Also, the rate on Fed funds will tend to rise now relative to the rate on C.D.'s because C.D.'s are of longer maturity. It is becoming increasingly clear that rates have peaked or soon will. In this case, rates are headed down and it is desirable to fund as short as possible. This gives another advantage to Fed funds, which, being overnight money, are the shortest maturity available. It is probably not an aberration that in recent days Fed funds have tended to trade up relative to the rates on C.D.'s.

Gordon B. Pye

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Market Yields

	3/28/80 (noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company			
Short-term loans to substantial depositors with highest credit rating	19.50%	19.00%	11.75%
Effective since	3/19/80		
Discount Rate at Federal Reserve Bank	13.00/16.00	13.00	9.50
Federal Funds	19.50	17.25	10.01
Repurchase Agreements	13.50	12.50	9.00
U.S. Treasury Issues			
Bills			
3 months	15.25	16.10	9.75
6 months	16.33	16.66	10.00
1 year	15.89	16.15	10.10
Coupons			
2 years	14.85	15.05	9.70
4 years	13.85	13.69	9.20
7 years	12.95	12.93	9.13
10 years	12.80	12.71	9.08
Long Bond	12.40	12.25	9.00
Negotiable Certificates of Deposit-Secondary Market			
1 month	17.25	17.50	9.80
3 months	18.15	18.00	9.95
6 months	18.45	18.10	10.30
1 year	17.25	17.50	10.60
Banker's Acceptances			
1 month	17.10	17.60	9.72
3 months	18.10	18.00	9.82
6 months	18.30	18.20	10.24
Eurodollar Deposits			
1 month	18.50	18.00	10.31
2 months	19.13	18.69	10.44
3 months	19.44	18.94	10.50
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	15.50	6.00	9.00
1 month	16.75	16.25	9.50
3 months	15.00	15.00	9.63
Bank Holding Companies			
1 month	16.50	16.50	9.63
Dealer Placed:			
3 months	17.25	16.88	9.75
New AA Corporate Utility Bond	14.25	14.15	9.80
Tax Exempt			
6 month Project Notes	8.75	7.20	5.20
1 year AAA Bond	8.00	N/A	N/A
5 year AAA Bond	8.10	N/A	N/A
20 year AAA Bond	9.10	9.10	5.85

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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